

(Regulations of the Fair Political Practices Commission, Title 2, Division 6, California Code of Regulations.)

§ 18705.1. Materiality Standard: Economic Interests in Business Entities.

(a) Introduction.

(1) If a business entity in which a public official has an economic interest is directly involved in a governmental decision (see Cal. Code Regs., tit. 2, section 18704.1(a)), use the standards in subdivision (b) of this regulation.

(2) If a business entity in which a public official has an economic interest is indirectly involved in a governmental decision (see Cal. Code Regs., tit. 2, section 18704.1(b)), use the standards in subdivision (c) of this regulation.

(b) Directly involved business entities.

(1) General Rule: Unless the exception in subdivision (b)(2) of this regulation applies, the financial effects of a governmental decision on a business entity which is directly involved in the governmental decision is presumed to be material. This presumption may be rebutted by proof that it is not reasonably foreseeable that the governmental decision will have any financial effect on the business entity.

(2) Exception: If the public official's only economic interest in the business entity is an investment interest (see Government Code section 87103(a)), and the public official's investment in the business entity is worth \$ 25,000 or less, then apply the materiality standards in subdivision (c)(1) of this regulation if the business entity is listed on the Fortune 500, or the materiality standards in subdivision (c)(2) of this regulation if the business entity is listed on the New York Stock Exchange, or if not listed on the New York Stock Exchange, for its most recent fiscal year had earnings before taxes of no less than:

(A) \$ 2.5 million, or

(B) such other amount described at Rule 102.01C of the New York Stock Exchange's Listed Company Manual (or any superseding rule of the New York Stock Exchange describing its financial standards for initial listing).

(c) Indirectly involved business entities. The following materiality standards apply when a business entity in which a public official has an economic interest is indirectly involved in a governmental decision. If more than one of the following subdivisions is applicable to the business entity in question, apply the subdivision with the highest dollar thresholds.

(1) If the business entity is listed in the Fortune 500, the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

(A) The governmental decision will result in an increase or decrease in the business entity's gross revenues for a fiscal year of \$ 10,000,000 or more; or

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$ 2,500,000 or more; or

(C) The governmental decision will result in an increase or decrease in the value of the business entity's assets or liabilities of \$ 10,000,000 or more.

(2) If the business entity is listed on the New York Stock Exchange, or if not listed on the New York Stock Exchange, for its most recent fiscal year had earnings before taxes of no less than \$ 2.5 million, or such other amount described at Rule 102.01C of the New York Stock Exchange's Listed Company Manual (or any superseding rule of the New York Stock Exchange describing its financial standards for initial listing), the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

(A) The governmental decision will result in an increase or decrease to the business entity's gross revenues for a fiscal year in the amount of \$ 500,000 or more; or,

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$ 200,000 or more; or,

(C) The governmental decision will result in an increase or decrease in the value of assets or liabilities of \$ 500,000 or more.

(3) If the business entity is listed on either the NASDAQ or American Stock Exchange, or if not so listed, for its most recent fiscal year had: net income of no less than \$ 500,000 (or such other amount described in the minimum financial requirements for continued listing on the NASDAQ SmallCap market), or earnings before taxes of no less than \$ 750,000 (or such other amount of earnings before taxes described under initial listing standard 1 of Section 101(a) of the Rules of the American Stock Exchange, or any superseding Section of the Rules of that Exchange), the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

(A) The governmental decision will result in an increase or decrease to the business entity's gross revenues for a fiscal year in the amount of \$ 300,000 or more; or,

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$ 100,000 or more; or,

(C) The governmental decision will result in an increase or decrease in the value of assets or liabilities of \$ 300,000 or more.

(4) If the business entity is not covered by subdivisions (c)(1)-(3), the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

(A) The governmental decision will result in an increase or decrease in the business entity's gross revenues for a fiscal year in the amount of \$ 20,000 or more; or,

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$ 5,000 or more; or,

(C) The governmental decision will result in an increase or decrease in the value of the business entity's assets or liabilities of \$ 20,000 or more.

(d) Terminology. The accounting terms described below are the same as, or not inconsistent with, terms used in Generally Accepted Accounting Principles and Generally Accepted Auditing Standards. Nothing in this subdivision should be construed to incorporate new items not contemplated under Generally Accepted Accounting Principles and Generally Accepted Auditing Standards, nor to exclude any items that might be included in the definitions of these terms under Generally Accepted Accounting Principles and Generally Accepted Auditing Standards

(1) Assets. As used in this section, "assets" means all property, real and personal, tangible and intangible, which belongs to any business entity. This includes, but is not limited to, cash, securities, merchandise, raw materials, finished goods, operating supplies, and ordinary maintenance material and parts, accounts receivable and notes and loans receivable, and prepaid expenses (such as prepaid insurance, interests, rents, taxes, advertising, and operating supplies).

(A) When a business entity holds a claim over collateral (including real property) as security for a loan made by the business entity, such a claim does not make the collateral

(including real property) an "asset" of the business entity, unless the business entity has initiated proceedings to foreclose upon, or acquire the asset based on the debtor's failure to repay the loan. The loan or note secured by the collateral is an asset.

(B) The definition of "assets" also includes intangible assets. Intangible assets, include, but are not limited to, long-lived legal rights and competitive advantages developed or acquired by a business enterprise, patents, copyrights, franchises, trademarks, organizational costs, goodwill, and secret processes.

(2) Earnings Before Taxes: Revenue, less the cost of goods sold and selling, general, and administrative expenses (but not excluding depreciation and amortization expenses); otherwise defined as operating and non-operating profit before the deduction of income taxes. Described variously as EBT, Income Before Income Taxes, or Income Before Provision for Income Taxes.

(3) Expenses: In general, the term refers to the current costs of carrying on an activity.

(4) Gross Revenue: Actual or expected inflows of cash or other assets. "Gross Revenue" is the revenue of a business entity before adjustments or deductions are made for returns and allowances and the costs of goods sold, and prior to any deduction for these and any other expenses.

(5) Liabilities: Obligations of the business entity, liquidation of which is reasonably expected to require the transfer of assets or the creation of other new liabilities. Any financial obligation or cash expenditures that must be made by the business entity at a specific time to satisfy the contractual terms of such an obligation.

(6) Net Income: A business entity's total earnings; otherwise defined as revenues adjusted for the costs of doing business, depreciation, interest, taxes, and other expenses. This amount is

usually found at the bottom of a business entity's Profit and Loss statement. Also described as Net Profit.

(e) Financial statements. In complying with this regulation, public officials may rely on the most recent independently audited financial statements of the business entity so long as those statements are reflective of the current condition of the business entity. Financial statements are not considered "reflective of the current condition of the business entity" where:

(1) The most recent independently audited financial statements of the business entity are for a fiscal year ending more than twenty-four months prior to the date of the governmental decision.

(2) The most recent audit of the financial statements resulted in an adverse opinion, was issued with a disclaimer, or was otherwise qualified in such a manner that the statement of assets, liabilities, expenses, or gross revenues is questioned in the audit report, or

(3) There has been a subsequent event, intervening between the date that the financial statement was created and the date of the decision of the public official, that makes the statement no longer representative, including, but not limited to, business reorganizations.

Comments: Electronic access to annual reports, quarterly reports, and other financial statements filed with the United States Securities and Exchange Commission ("SEC") may be obtained by accessing the SEC's website and selecting its EDGAR database of statutory filings: <http://www.sec.gov/edgar/searchedgar/companysearch.html>.

The earnings before taxes and net income criteria for listing on the New York and American Stock Exchanges, and NASDAQ may be obtained through links from the following webpages:

New York Stock Exchange: <http://www.nyse.com/listed/listed.html>.

American Stock Exchange:

<http://wallstreet.cch.com/AmericanStockExchangeAMEX/>.

NASDAQ:

<http://www.nasdaq.com/about/nasdaq.listing.req.fees.pdf>.

Note: Authority cited: Section 83112, Government Code. Reference: Sections 87100, 87102.5, 87102.6, 87102.8 and 87103, Government Code.

HISTORY

1. New section filed 11-23-98; operative 11-23-98 pursuant to the 1974 version of Government Code section 11380.2 and title 2, California Code of Regulations, section 18312(d) and (e) (Register 98, No. 48).
2. Change without regulatory effect amending section, heading filed 3-26-99 pursuant to section 100, title 1, California Code of Regulations (Register 99, No. 13).
3. Editorial correction of 1 (Register 2000, No. 25).
4. Repealer and new section filed 1-18-2001; operative 2-1-2001. Submitted to OAL for filing pursuant to *Fair Political Practices Commission v. Office of Administrative Law*, 3 Civil C010924, California Court of Appeal, Third Appellate District, nonpublished decision, April 27, 1992 (FPPC regulations only subject to 1974 Administrative Procedure Act rulemaking requirements) (Register 2001, No. 3).
5. Amendment filed 1-16-2003; operative 1-16-2003. Submitted to OAL for filing pursuant to *Fair Political Practices Commission v. Office of Administrative Law*, 3 Civil C010924, California Court of Appeal, Third Appellate District, nonpublished decision, April 27, 1992 (FPPC regulations only subject to 1974 Administrative Procedure Act rulemaking requirements) (Register 2003, No. 3).